Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term 1976

No. 76-550

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

PERCY D. AYRES,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in this action on June 28, 1976, as to which a timely petition for rehearing was denied on July 22, 1976. The Court of Appeals reversed a judgment entered on July 7, 1975 by the United States District Court for the Eastern District of Pennsylvania confirming a decision rendered by arbitrators of the New York Stock Exchange, Inc. ("NYSE" or "Exchange") dismissing respondent's complaint against petitioner.

Citations to Opinions Below

The opinion of the United States District Court for the Eastern District of Pennsylvania, granting petitioner's motion to stay the action pending arbitration, is reported at 353 F.Supp. 1084 (E.D. Pa. 1973), and is annexed hereto

as Appendix B.* The opinion of the United States Court of Appeals for the Third Circuit, reversing the judgment of the District Court which had confirmed the arbitrators' award and dismissed respondent's complaint, is reported at 538 F.2d 532 (3d Cir. 1976), and is annexed hereto as Appendix C.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit was entered on June 28, 1976. *See* Appendix D. Petitioner's timely petition for rehearing was denied by the Court of Appeals on July 22, 1976. *See* Appendix E.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented For Review

This petition presents the following questions concerning the Securities Exchange Act of 1934 (the "Exchange Act") and Exchange Rule 347(b), which requires a registered representative of the Exchange to arbitrate any controversy arising out of his employment or termination of employment with a member organization:

1. Is Exchange Rule 347(b) applicable to a claim by a registered representative that his employer, a member organization which was then a private corporation, violated Section 10(b) of the Exchange Act and Rule 10b-5 when it exercised, upon the employee's retirement, an option to repurchase shares of the organization's stock acquired by the employee pursuant to an employee stock subscription agreement?

* Page references to the annexed appendices are suffixed "a".

2. If Rule 347(b) applies on its face to such a claim by a registered representative against his employer, is it nevertheless invalid under Section 29(a) of the Exchange Act?

3. Does Section 28(b)(2) of the Exchange Act exempt such a dispute between a member organization and its registered representative from the non-waiver provision contained in Section 29(a) of the Act?

Statutes and Rules Involved

This petition presents questions of law involving interpretations of the following statutes and rules:

Rule 347(b) of the Rules of the Board of Governors of the NYSE, 2 CCH New York Stock Exchange Guide ¶ 2347, provided:*

> "(b) Any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of any party, in accordance with the arbitration procedure prescribed elsewhere in these rules."

Section 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation there-

* Subsection (a) of Rule 347 was eliminated effective May 1, 1975 and the Rule is now known as Rule 347.

under, or of any rule of an exchange required thereby shall be void."

Section 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), provided, in relevant part:*

> "Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby. . . ."

Section 3 of the United States Arbitration Act, 9 U.S.C. § 3, provides:

> "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

The complaint involves claims asserted under the common law and Section 10(b) of the Exchange Act, 15 U.S.C.

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* This petition quotes the statute as it existed in 1971, when this action was commenced. The Court of Appeals cited the statute as it was amended in 1975, although, as the Court noted (37a n. 16), the amendments did not take effect until June 4, 1975, were not retroactive, and do not, in any event, affect the resolution of the issues presented herein.

§ 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, which provide, respectively:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."
>
> • • •
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

Statement of the Case

Respondent Percy D. Ayres ("Ayres") was employed by petitioner Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), a securities brokerage firm and a member of the Exchange, as a registered representative in its Philadelphia branch office from 1940 until his retirement on October 1, 1970. One benefit of Ayres' employment was the opportunity to purchase stock of Merrill Lynch, which was then a private corporation. The stock subscription agreements, pursuant to which Ayres was permitted to purchase his stock, specifically provided that Merrill Lynch could "at any time and from time to time" repurchase all or any part of his stock upon the giving of appropriate notice.

In January 1962 and again in December 1964, Ayres purchased an aggregate of 2,000 shares of Merrill Lynch non-voting common stock, at an aggregate cost of $49,741.50. As a result of subsequent stock splits, Ayres owned a total of 8,000 shares at the time of his retirement in 1970.

The complaint charges that in the summer of 1970 Ayres advised Merrill Lynch that he intended to retire on October 1, 1970.* Thereafter, he asked his office manager whether he would be permitted to retain his Merrill Lynch stock following his retirement. He was promptly advised that Merrill Lynch would exercise its option upon his retirement. Ayres nevertheless retired on October 1, 1970 and Merrill Lynch did, in fact, exercise its option. Upon such exercise, Ayres received $209,064.00 for the 8,000 shares, realizing a profit in excess of $150,000. (13a-14a).

The complaint further alleges that on July 14, 1970 Merrill Lynch made an "initial decision" to become a publicly owned corporation and that it set up a task force to compile information necessary for a prospectus for a public offering in the spring of 1971. Ayres claims that the facts

* The complaint is annexed hereto as Appendix A.

with respect to this initial decision were "wrongfully concealed" from him. Had he known of these facts, he charges, he would not have retired from Merrill Lynch's employ in October 1970 and Merrill Lynch would not have exercised its option to repurchase his stock. In that event, he could have sold his stock at a substantial profit on the public offering of Merrill Lynch's common stock which occurred on June 23, 1971. The nondisclosure of this information allegedly constituted a violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and of common law principles of fiduciary duty.*

On December 15, 1971 Ayres filed an action in the United States District Court for the Eastern District of Pennsylvania seeking rescission of the sale of his stock to Merrill Lynch and/or damages. The District Court's jurisdiction was based upon Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. § 1332. (1a, ¶ 2). Merrill Lynch promptly moved, pursuant to Section 3 of the United States Arbitration Act, to stay the action pending arbitration of the controversy pursuant to Exchange Rule 347(b), which requires an Exchange registered representative to arbitrate any controversy with a member organization arising out of the registered representative's employment or termination of employment with the member.

Ayres opposed the motion to stay, arguing that Rule 347(b) did not apply to this dispute. He further argued that any agreement to arbitrate this controversy under the Rules of the NYSE was void and unenforceable under the non-waiver provision of the Exchange Act, Section 29(a), and the doctrine of *Wilko* v. *Swan*, 346 U.S. 427 (1953).

* There is no allegation that the information was withheld from respondent with an "intent to deceive, manipulate, or defraud". *See Ernst & Ernst* v. *Hochfelder*, 44 U.S.L.W. 4451, 4454 (U.S. March 30, 1976).

The District Court granted Merrill Lynch's motion to stay the action pending arbitration on January 19, 1973. Ayres sought to appeal to the United States Court of Appeals for the Third Circuit from the stay order, but his appeal was dismissed by the Court of Appeals on April 27, 1973 for lack of the requisite finality.

Thereafter, Ayres commenced an arbitration proceeding against Merrill Lynch before the NYSE. His claim in arbitration was a copy of his complaint filed in the District Court. The matter was arbitrated before five arbitrators who, on May 19, 1975, rendered a unanimous award in favor of Merrill Lynch dismissing Ayres' claims under the federal securities laws and for common law breach of fiduciary duty. On July 7, 1975 judgment was entered in the District Court in favor of Merrill Lynch.

Ayres appealed to the United States Court of Appeals for the Third Circuit from the District Court's judgment confirming the award. The Court of Appeals, over District Judge Stern's dissent, vacated the July 7, 1975 judgment and remanded the case to the District Court. The Court concluded that NYSE Rule 347(b) did not, by its terms, apply to the controversy at bar and, in any event, was unenforceable and invalid under the non-waiver provision of the Exchange Act, Section 29(a).

REASONS FOR GRANTING THE WRIT

The Decision Of The Court Below Presents Important Questions Of Federal Law Which Have Not Been, But Should Be, Decided By This Court.

This case presents an important issue involving the reconciliation of competing public policies: on the one hand, the right of a national securities exchange, under the

Exchange Act, to settle by arbitration disputes between its members and registered representatives and, on the other hand, the right of public investors in securities, under the Exchange Act, to litigate alleged federal securities law claims in a judicial forum. The Court of Appeals' opinion also raises the question whether Section 28(b)(2) can ever be raised as an exception to the non-waiver provision contained in Section 29(a) of the Exchange Act.

In overturning a judgment based upon an NYSE arbitration between a member organization and a registered representative of the Exchange, the Court of Appeals misconstrued Exchange Rule 347(b); erroneously applied the non-waiver provision of the Exchange Act; and misinterpreted the exemption from the non-waiver provision of the Act, Section 28(b), contrary to the clear meaning of the statute and the intent of Congress. Indeed, the Court of Appeals' opinion rendered Section 28(b)(2) nugatory. The net result has been to seriously undermine the Exchange's right, and the right of its member organizations, to resolve controversies between member organizations and their registered representatives by arbitration.

We note further that the Securities and Exchange Commission sought leave to, and did, file an *amicus* brief with the Court of Appeals in support of respondent Ayres on the ground that the issues on appeal were of "substantial importance to the effective operation of the Federal securities laws". We agree. The questions are of substantial importance and sould be resolved by this Court.

I.

NYSE Rule 347(b) Is Applicable To This Dispute.

There is no dispute that the NYSE had jurisdiction over respondent Ayres. The District Court found that in April 1945 Ayres applied to the NYSE to become a regis-

tered representative and, in so doing, specifically submitted himself to the Exchange's jurisdiction. In December 1961 he applied to the Exchange for permission to become a holder of Merrill Lynch common stock and again pledged to be bound by the constitution and rules of the NYSE. Rule 347(b) of the NYSE, promulgated in 1958, requires a registered representative to arbitrate "any controversy" between himself and a member organization "arising out of the employment or termination of employment of such registered representative" with such member.

The District Court, in granting the motion to stay in January 1973, found that Ayres acquired Merrill Lynch stock "*solely* because of his status as an employee" of Merrill Lynch (23a) (emphasis in original), and that his subscription agreements gave Merrill Lynch the right to repurchase that stock at any time. (13a). It concluded that the transaction in dispute "can only be construed as arising out of [Ayres'] employment as a registered representative with Merrill Lynch." (19a).

The Court of Appeals, in reversing the District Court, stated that the question was "not free from doubt". It ruled, however, that Rule 347(b) was limited to disputes involving an employee's consensual arrangements with his employer relating to "terms and conditions" of employment. Alleged securities claims, the Court said, which "in a purely factual sense, . . . are connected with the termination of employment" fall outside the perimeter of the Rule. The Court stated the legal rights being asserted had a source "wholly independent of the employment relationship" (32a)—despite the fact that the complaint alleged that Merrill Lynch had breached duties it owed to Ayres "as an employee and stockholder". (8a, ¶ 37).

Contrary to the ruling of the Court of Appeals, the rights which Ayres claimed were violated arose out of, and

were wholly dependent upon, his employment relationship with Merrill Lynch. His complaint is based squarely on the claim that, had he not terminated that relationship, Merrill Lynch would not have exercised its option.

Rule 347(b), moreover, is not limited in the way the Court of Appeals has suggested. The Rule applies to *any* controversy arising out of a registered representative's employment or termination of employment. *See Stokes* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 523 F.2d 433, 437 (6th Cir. 1975). The Court's restrictive view of the scope of the Rule, finally, disregards the fact that the Exchange itself considered Rule 347(b) as applicable when it took jurisdiction of this controversy and rendered an arbitration award, despite the protests of Ayres that Rule 347(b) did not apply.

The Court of Appeals relied on *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973), as authority for its narrow construction of Rule 347(b). That case, however, is wholly inapposite. There, the issue was whether the arbitration provision of Rule 347(b) could be overridden by state legislation prohibiting arbitration of certain classes of disputes—in that case, a dispute over wages; or whether Rule 347(b) preempted conflicting state legislation. Here, however, there is no state legislation which purports to preclude the application of Rule 347(b) and this Court's comments in that case concerning the necessity or desirability of "nationwide uniformity of an Exchange's housekeeping affairs" are in no way relevant to the issue presented here. Thus, *Ware* does not support the conclusion below that a dispute between a registered representative and his employer concerning a compulsory sale of stock upon retirement is beyond the intended scope of Rule 347(b).

II.

The Court Of Appeals Misapplied Section 29(a) Of The Exchange Act And Misconstrued Section 28(b)(2) Of That Act.

The Court of Appeals held that if Exchange Rule 347(b) were applicable to this case, it would be invalid and unenforceable under Section 29(a) of the Exchange Act. In reaching this conclusion, the Court of Appeals relied upon *Wilko* v. *Swan,* 346 U.S. 427 (1953), which held that the remedy of a judicial civil action, provided by Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), could not be waived in advance by a *customer* of a brokerage firm. The Court thus held that an arbitration provision in a margin agreement, which purported to effect such a waiver, was invalid under Section 14 of the Securities Act, 15 U.S.C. § 77n.

A. Section 29(a) Should Not Apply To Implied Causes Of Action Under The Exchange Act.

Although lower federal courts have ruled that implied remedies under Section 10(b) of the Exchange Act are subject to the non-waiver provision of the Exchange Act, *see,* e.g., *Stockwell* v. *Reynolds & Co.,* 252 F. Supp. 215 (S.D.N.Y. 1965), this Court has never ruled on that issue. We submit that the *Wilko* doctrine of non-waiver should *not* apply to implied causes of action under the Exchange Act and that Wilko does not justify the invalidation of Exchange Rule 347(b) which mandated arbitration of this dispute between Merrill Lynch and its employee.

The doctrine enunciated in *Wilko* should be limited to the waiver of express civil remedies under the federal securities laws inasmuch as it was premised on the specific intent of Congress to preserve a judicial forum for the litigation of the "special right" of action provided by Section

12 of the Securities Act. 346 U.S. at 431. Section 10(b) of the Exchange Act, however, provides no such special right of a private remedy. As this Court noted in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 759 (1975), a private right of action under Rule 10b-5 was "not authorized by the legislation". It cannot be said here, therefore, that Congress intended the non-waiver provision to apply to implied claims for relief which Congress has never authorized.

This distinction was pointed out in dictum by this Court in *Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506, 513-14 (1974). It is one thing for the courts judicially to create a civil remedy where Congress has not expressly authorized one; it is quite another for a court to invalidate an Exchange rule of arbitration, enforceable under Section 3 of the United States Arbitration Act, solely to enable a registered representative of the Exchange to litigate in court a private right of action which Congress did not authorize.

B. Section 28(b)(2) Exempts This Controversy From The Non-Waiver Provision Of Section 29(a) Of The Exchange Act.

Even if the non-waiver provision of Section 29(a) were found to apply to implied causes of action under Section 10(b), the Court of Appeals nevertheless erred in holding that the exemption from that provision contained in Section 28(b) is inapplicable. The Court's interpretation of Section 28(b) has created an anomalous distinction between members and allied members of the Exchange, who are subject to the Exchange's jurisdiction and rules, and registered representatives of the Exchange, who have similarly submitted themselves to the Exchange's jurisdiction and pledged to abide by its constitution and rules.

Notwithstanding *Wilko,* the courts have repeatedly held that members and allied members are bound under Exchange rules to arbitrate claims under Section 10(b) of the Exchange Act and Rule 10b-5. *See,* e.g., *Brown* v. *Gilligan, Will & Co.,* 287 F. Supp. 766, 772 (S.D.N.Y. 1968); *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd,* 451 F.2d 838 (2d Cir. 1971); *Cocnen* v. *R. W. Pressprich & Co., Inc.,* 453 F.2d 1209 (2d Cir.), *cert. denied,* 406 U.S. 949 (1972). Such disputes fall within Section 28(b)(1) of the Exchange Act, which preserves existing law with regard to the binding effect of "action" taken by the Exchange to settle disputes between its members. Indeed, the Court of Appeals agreed with petitioner that the phrase "action . . . of such exchange to settle disputes", as it is used in Section 28(b)(1), includes the promulgation of rules of arbitration as well as the actual arbitration of a pre-existing dispute. (38a).

Section 28(b)(2) of the Exchange Act preserves existing law with regard to the binding effect of "such action", i.e., action of the Exchange in prescribing compulsory arbitration rules, on "any person who has agreed to be bound thereby". Considering that the purpose of Section 28 was to promote the self-regulatory functions of the Exchange, it is clear that Congress did not intend to limit the term "any person", as used in Section 28(b)(2), only to persons who are members or allied members of the Exchange. Thus, the District Court correctly concluded that a registered representative of the Exchange who submits himself to its jurisdiction and agrees to be bound by all its rules, including Rule 347 (b), falls within the meaning of the phrase "any person who has agreed to be bound thereby".

In reversing the District Court, the Court of Appeals held that the term "such action" in subsection 2 of Section 28(b) refers only to the settlement of disputes between "members or participants". (38a). In so holding the Court, in effect, read out of the statute the term "any person" and ruled that the exemption under Section 28(b)(2) goes no further than the reference to "any member of an exchange" contained in Section 28(b)(1). Courts, however, should not construe a statute in such a way as to render any portion of it redundant. *United States* v. *Menasche,* 348 U.S. 528, 538 (1955); 2A Sutherland, *Statutory Construction* § 46.06 (4th ed. 1973).

Under the Court of Appeals' reasoning, there is no way that "any person", who happens to be a non-member, could ever enter into a valid and effective agreement to be bound by the Exchange's "action" in prescribing rules of arbitration if being a member (or "participant" under the 1975 amendment) is a necessary prerequisite to the operation of Section 28(b)(2). The statute itself contains no such limitation and it should not be read to create a result never intended by Congress.

Conclusion

The ruling of the Court of Appeals seriously impedes the ability of the NYSE to regulate its members and to provide for the resolution of controversies between members and registered representatives pursuant to its own rules. The erroneous distinction which the Court of Appeals has created between categories of persons who are equally subject to the Exchange's jurisdiction and bound by its constitution and rules should be corrected by this Court.

For the reasons set forth, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix A—Complaint

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 71-2986

PERCY D. AYRES
370 Sycamore Avenue
Merion, Pennsylvania 19066

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
70 Pine Street
New York, New York

Defendant.

Jury Trial Demanded

COMPLAINT

1. This action arises out of the violation by defendant of section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 of the Securities Exchange Commission promulgated thereunder; and common law principles.

2. This Court has jurisdiction of this action under section 27 of the Securities Exchange Act of 1934, as amended (15 U.S.C. § 78aa), and 28 U.S.C. § 1332.

3. Plaintiff is a citizen of the Commonwealth of Pennsylvania who resides at 370 Sycamore Avenue, Merion, Pennsylvania 19066.

4. Defendant is a Delaware corporation whose principal place of business is at 70 Pine Street, New York, New York, which is qualified to do business in the Common-

wealth of Pennsylvania, and whose registered office in Pennsylvania is CT Corporation System, 123 South Broad Street, Philadelphia, Pennsylvania. Defendant functions as a broker in securities and commodity futures contracts, a dealer in corporation and municipal securities and United States government and agency obligations, and an investment banking firm. Defendant has approximately 200 offices located throughout the United States, including offices at 4 Penn Center Plaza, Philadelphia, Pennsylvania and elsewhere in the Eastern District of Pennsylvania.

5. The matter in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

6. In 1934 plaintiff was employed as a bond trader by Cassatt & Company, which was merged into defendant in 1940. In and after 1940 plaintiff was employed by defendant in defendant's Philadelphia office as an account executive until his voluntary retirement on October 1, 1970, two days prior to his 68th birthday.

7. On January 26, 1962, plaintiff purchased from defendant 1500 shares of non-voting common stock of defendant. In connection with said purchase plaintiff and defendant entered into Stock Subscription Agreement, Non-Voting Common Stock, dated January 26, 1962, which agreement, *inter alia,* conferred on defendant certain repurchase rights in connection with said shares.

8. On December 14, 1964, plaintiff purchased an additional 500 shares of non-voting common stock of defendant. In connection with said purchase plaintiff and defendant entered into Subscription Agreement, Non-Voting Common Stock, Additional Purchase of Shares, dated December 14, 1964, which agreement, *inter alia,* incorporated the terms, conditions and representations of the agreement referred to in paragraph 7 above.

9. In 1966, pursuant to a 2-for-1 stock split, plaintiff received from defendant 2000 shares of non-voting common stock of defendant, resulting in the ownership by plaintiff of 4000 of such shares.

10. In 1969, pursuant to a 2-for-1 stock split, plaintiff received from defendant 4000 shares of non-voting common stock of defendant, resulting in the ownership by plaintiff of 8000 of such shares.

11. On October 3, 1967, plaintiff attained the age of 65 years. Under defendant's employee retirement policy then in effect, defendant's employees who attained the age of 65 years were required to retire from defendant's employ, provided, however, that at the discretion of defendant such of defendant's employees as attained the age of 65 years but remained productive employees of defendant were thereafter permitted to remain in defendant's employ on a year-to-year basis, with mandatory retirement at the age of 70 years.

12. Pursuant to the policy referred to in paragraph 11 above, plaintiff remained in defendant's employ after October 3, 1967.

13. On March 26, 1970, the rules and regulations of the New York Stock Exchange ("NYSE"), of which defendant was then and is now a member, were amended so as to permit corporate members of the NYSE to offer their stock for sale to the public.

14. On or about July 14, 1970, defendant's management made the initial decision to have defendant become a publicly owned corporation. Defendant's management maintained in confidence the fact that said initial decision had been made, and wrongfully concealed from defendant's employees and others, including plaintiff, until the summer

of 1971 the fact that said initial decision had been made on or about July 14, 1970.

15. On or about July 14, 1970, in implementation of the initial decision referred to in paragraph 14 above, defendant's management established a "Going Public Task Force", composed of George Shinn, A. Hampton Frady and Robert Spies, for the purpose of arranging for an audit of defendant on a scheduled basis and the compilation of data for the preparation of a prospectus for the stock of defendant to be offered for sale to the public. Defendant's management maintained in confidence the fact that said task force had been established, and wrongfully concealed from defendant's employees and others, including plaintiff, until the summer of 1971 the fact that said task force had been established on or about July 14, 1970.

16. In making the initial decision referred to in paragraph 14 above, and in establishing the "Going Public Task Force" referred to in paragraph 15 above, defendant's management had as its goal on and after July 14, 1970 a public offering of defendant's stock in the spring of 1971. Defendant's management maintained in confidence the fact that it had established said goal, and wrongfully concealed from defendant's employees and others, including plaintiff, until the summer of 1971 the fact that said goal had been established on or about July 14, 1970.

17. During the months of July, August and September 1970 defendant's "Going Public Task Force" proceeded promptly with preparations for the sale of defendant's stock to the public, with the result that notwithstanding the delay caused by the request by the NYSE in November 1970 that defendant acquire Goodbody Co., by December 1970 the first typewritten manuscript of defendant's prospectus for said stock was being completed.

18. During the late summer of 1970, plaintiff advised defendant of his intention to retire from defendant's employ on October 1, 1970.

19. At the time he so advised defendant, plaintiff believed that he would be permitted by defendant to retain, following his retirement, the 8000 shares of non-voting common stock of defendant which he then owned.

20. Thereafter, but before October 1, 1970, having been advised by a fellow employee that he would likely be required by defendant to sell said stock to defendant if and when he retired, plaintiff asked Edward F. Ryan, Vice President of defendant and manager of defendant's Philadelphia office, whether plaintiff would be permitted to retain said stock following his retirement. Mr. Ryan advised plaintiff that he would take up plaintiff's request with defendant's offices in New York, New York.

21. Thereafter, defendant, wrongfully concealing the facts set forth in paragraphs 14, 15, 16 and 17 above, through Mr. Ryan advised plaintiff that upon his retirement plaintiff would be required to sell said stock to defendant, which he thereafter was required to do on or about October 1, 1970, for the price of $26.133 per share, or a total of $209,064. Plaintiff mailed certificates representing said shares from Philadelphia, Pennsylvania, to defendant's offices at 570 Broad Street, Newark, New Jersey, and defendant mailed its check in payment for said shares from its offices at 570 Broad Street, Newark, New Jersey, to plaintiff's home in Merion, Pennsylvania.

22. By June 23, 1971 plaintiff's stock of defendant, if then owned by plaintiff, could have been sold by plaintiff to the public for $672,000, and subsequent thereto said stock became even more valuable.

23. Had plaintiff not retired on October 1, 1970, and thereafter remained physically capable of discharging his duties for defendant (which he did), plaintiff could have remained in defendant's employ until he attained the age of 70 years on October 3, 1972.

24. Had plaintiff not retired on October 1, 1970, plaintiff would not then have been required to sell to defendant his stock of defendant, nor could he thereafter have been required to sell to defendant his stock of defendant if he remained in defendant's employ until the date on which the action referred to in paragraph 34 below was taken.

25. Had defendant advised plaintiff prior to October 1, 1970, when plaintiff specifically inquired of defendant whether plaintiff would be permitted to retain his stock of defendant upon voluntarily retiring from defendant's employ, that it had initially decided on or about July 14, 1970 to have defendant become a publicly owned corporation, that on or about July 14, 1971 it had established a "Going Public Task Force" and that said "Going Public Task Force" was proceeding promptly with preparations for the sale of defendant's stock to the public, and that in making said initial decision and in establishing said task force defendant's management had as its goal a public offering of defendant's stock in the spring of 1971, plaintiff would not have retired from defendant's employ and would not have sold to defendant his stock of defendant, it being highly probable that plaintiff's stock of defendant would increase significantly in value.

26. On April 20, 1971, the stockholders of defendant approved the proposal of defendant's management that defendant become a public corporation.

27. On or about April 20, 1971, each holder of non-voting common shares of defendant received therefor three shares

of the then newly-authorized common stock, par value $1.333 per share, of defendant.

28. Had plaintiff been the owner of 8000 shares of defendant's non-voting common stock prior to said split, as a result of said split he would have been the owner of 24,000 shares of the then newly authorized common stock of defendant.

29. On or about April 23, 1971 defendant filed with the Securities Exchange Commission a registration statement and prospectus for the shares of defendant to be sold to the public.

30. During the four month period ending April 30, 1971, defendant paid a cash dividend of $.10 a share on its common stock. Had plaintiff been the owner of 24,000 shares of defendant's common stock at that time, he would have received a total dividend payment of $2,400.

31. On or about June 23, 1971, defendant made a public offering of approximately 2,000,000 shares of its common stock to the public for the price of $28.00 per share. At that time, and in connection with said offering, 2,000,000 shares of its common stock which were then owned by, *inter alia*, directors, officers and employees of defendant, were registered with the Securities Exchange Commission and offered for sale to the public for the price of $28.00 per share.

32. All, or substantially all of the 4,000,000 shares of the common stock of defendant which were offered for sale to public in the offering referred to in paragraph 31 above were purchased by the public for $28.00 per share.

33. On or before June 23, 1971, shares of defendant's common stock which were owned by the then shareholders of defendant (other than the shares referred to in paragraph 31 above) were made subject to the restriction that said shares could not be sold, optioned for sale or other-

wise disposed of by said shareholders for a period of one year from the termination of the offering referred to in paragraph 31 above.

34. Except for the restriction referred to in paragraph 33 above, on or before June 23, 1971, defendant acted to remove from its common stock which was then owned by its then shareholders all restrictions relating to transferability and acquisition rights of defendant arising under defendant's Articles of Incorporation, as amended, By-Laws, as amended, Stock Purchase Plan, as amended, and subscription agreements with its shareholders.

35. On August 16, 1971, defendant paid a cash dividend of $.10 a share on its common stock. Had plaintiff been the owner of 24,000 shares of defendant's common stock on that date, he would have received a total dividend payment of $2,400.

36. On November 24, 1971, defendant paid a cash dividend of $.10 a share on its common stock. Had plaintiff been the owner of 24,000 shares of defendant's common stock on that date, he would have received a total dividend payment of $2,400.

37. In failing to advise plaintiff prior to October 1, 1970, of the facts set forth in paragraphs 14, 15, 16, and 17 above, defendant violated section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the Securities Exchange Commission promulgated thereunder, and defendant breached the fiduciary duties and duty of good faith and common honesty which were owed by defendant to plaintiff as an employee and stockholder of defendant, in that defendant wrongfully failed to disclose to plaintiff material facts relating to stock of defendant which facts were known to defendant but were unknown to plaintiff, and which facts if known to plaintiff would have influenced him not to sell

to defendant the stock of defendant which was owned by him and thus not to retire from defendant's employ.

WHEREFORE, plaintiff demands judgment against defendant for:

a. Recission of the October 1, 1970 sale by plaintiff to defendant for $209,064 (which amount plaintiff hereby offers to return to defendant) of plaintiff's 8,000 shares of defendant's non-voting common stock, par value $4.00 per share, and conversion of said 8,000 shares into 24,000 shares of defendant's common stock, par value $1.333 per share, and damages in an amount equal to the dividends which would have been payable by defendant to plaintiff on plaintiff's stock of defendant had said October 1, 1970, sale not taken place, and interest; *or*

b. Damages suffered by plaintiff as the result of defendant's aforesaid wrongful conduct, which damages exceed $500,000.00, and interest; *and*

c. Costs and expenses of this action, including reasonable attorneys' fees; *and*

d. Such other and further relief as may be necessary and appropriate.

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Appendix B—Opinion of the District Court

UNITED STATES DISTRICT COURT,

E. D. PENNSYLVANIA.

Civ. A. No. 71-2986.

———o———

PERCY D. AYRES

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

———o———

Jan. 19, 1973.

DAVID L. GROVE, MONTGOMERY, MCCRACKEN, WALKER & RHOADS, Philadelphia, Pa., *for plaintiff*.

C. CLARK HODGSON, JR., STRADLEY, RONON, STEVENS & YOUNG, Philadelphia, Pa., *for defendant*.

HIGGINBOTHAM, *District Judge*.

OPINION

The defendant, Merrill Lynch, Pierce, Fenner & Smith, Inc., (hereinafter referred to as "Merrill Lynch") moves to stay all proceedings in this action pending arbitration of the questions presented by the plaintiff, in accordance with the constitution and rules of the New York Stock Exchange (hereinafter referred to as "NYSE"). The underlying question raised by the defendant's motion is whether a non-member registered representative who purchases securities from an employer-member firm solely as a result of his employment is subject to Rule 347(b) of the New York Stock Exchange, which compels arbitration of employment-related disputes? Phrased differently, does a non-member registered representative have the same legal rights which a customer non-employee would have? For reasons which hereinafter follow, the Court concludes that defendant's motion shall be granted and this controversy shall be submitted to arbitration.

This action was brought by the plaintiff, Percy D. Ayres, pursuant to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970) ("the 1934 Act"), and Rule 10b-5 of the Securities Exchange Commission promulgated thereunder, 17 C.F.R. § 240.10b-5 (1972). Jurisdiction is vested in the Court under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1970) and 28 U.S.C. § 1332 (1970).

Ayres was employed as an account executive and registered representative in defendant's Philadelphia office from 1940 until his voluntary retirement on October 1, 1970, two days prior to his 68th birthday. The defendant's retirement policy required its employees attaining the age of 65 years to retire, provided, however, that at the discretion of the defendant those employees, who upon attaining the foregoing age but who remain productive employees, were thereafter permitted to continue in defendant's employ on a year-to-year basis, with mandatory retirement at the age of 70 years. Pursuant to this policy, plaintiff remained in defendant's employ after he had reached 65 years of age on October 3, 1967.

Merrill Lynch is a member of the NYSE and is subject to its constitution, rules and regulations. Under Rule

345(a) of the Rules of the Board of Governors of the Exchange no member or member organization shall:

> "(1) Permit any persons to perform regularly the duties customarily performed by a registered representative, unless such person shall have been registered with and is acceptable to the Exchange."

In accordance with Rule 345, plaintiff submitted the required NYSE Form No. RE-1 on April 16, 1945, and his application to become a registered representative was accepted in May, 1945.

In becoming a registered representative, Ayres agreed to submit to the jurisdiction of NYSE.[1] On April 17, 1958, the Board of Governors adopted Rule 347(b) which required disputes pertaining to employment between registered representatives and members of the Exchange to be resolved by arbitration.[2] On December 19, 1961, plaintiff again pledged himself to be bound by the constitution and rules

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[1] Paragraph 31 of NYSE Form No. RE-1 provided:

> "I hereby certify that the following statements are true and complete, and in consideration of the New York Stock Exchange's approving my application, I submit myself to the jurisdiction of such Exchange, and I agree as follows:
>
> * * *
>
> "(g) I am familiar with the rules and regulations of the New York Stock Exchange pertaining to the employment of so-called registered employees, and I agree to abide by the existing rules and all amendments thereto."

[2] NYSE Rule 347(b) stated:

> "(b) Any controversy between a registered representative and any member organization arising out of the employment or termination of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of any such party in accordance with the arbitration procedure prescribed elsewhere in these rules."

of the Board of Governors of the Exchange and any amendments thereto, when he applied to the Exchange for approval as a holder of 1500 shares of non-voting common stock of Merrill Lynch, pursuant to Article IX, Section 7 of the Constitution of the Exchange; plaintiff's application was approved by the Exchange in January, 1962.

On January 26, 1962, and December 14, 1964, plaintiff purchased from Merrill Lynch 1500 shares and 500 shares, respectively, of its non-voting common stock at costs of $32,415 and $17,326.50. By reason of subsequent two-for-one stock splits in 1966 and 1969, plaintiff's original purchases of 2000 shares of non-voting common stock had increased to 8000 shares at the time of his retirement on October 1, 1970. With each acquisition of defendant's stock plaintiff executed a Stock Subscription Agreement which provided, among other things, that Merrill Lynch reserved the right at any time to purchase all or any part of plaintiff's stock for a period of 90 days from the date defendant furnished plaintiff with written notice that it had elected to exercise its purchase rights.

The rules and regulations of the NYSE were further amended on March 26, 1970, so as to permit corporate members of the NYSE to offer their stock for sale to the public. As a result of this amendment, plaintiff's complaint alleges that on or about July 14, 1970, Merrill Lynch initially decided to become a publicly owned corporation, but wrongfully concealed from plaintiff and others this information until the summer of 1971, even though in July, 1970, defendant's management had set as its goal a public offering of its stock in the Spring of 1971. Moreover, in implementation of this July, 1970 decision, defendant established a secret "Going Public Task Force" to compile data for the

preparation of a prospectus for defendant's stock that would be publicly offered for sale.

During the late summer of 1970 when plaintiff advised defendant of his intention to retire, he was informed by the Vice-President of Merrill Lynch and manager of its Philadelphia office that upon plaintiff's retirement he would be required to sell his 8000 shares of defendant's stock to defendant on or about October 1, 1970, for the price of $26.133 per share, or a total of $209,064. Had Ayres not sold the stock to Merrill Lynch, he contends that by June 23, 1971, when Merrill Lynch had its first public offering, he could have sold the same stock to the public for $672,000. Furthermore, due to a three-for-one stock split in April, 1971, plaintiff would have received a dividend payment of $2400, $0.10 a share on the 24,000 shares he then would have owned. Similarly, there were additional dividend payments in the amount of $0.10 per share in August, 1971 and November, 1971.

Finally, on or before June 23, 1971, Merrill Lynch removed from its owners of common stock all restrictions relating to transferability and acquisition rights of defendant, with the single exception being that the current owners of common stock could not sell, option for sale, or otherwise dispose of the shares for a period of one year from the termination of the public offering held in June, 1971. Plaintiff therefore contends that if Merrill Lynch had not breached its fiduciary duties owed to him by failing to disclose material facts affecting the value of the stock, then he would not have retired on October 1, 1970, and after June 23, 1971, he would have been subject only to the single restriction noted earlier in this paragraph.

In opposition to defendant's motion to stay these proceedings pending arbitration, plaintiff advances several arguments, viz.: (1) This controversy is not subject to arbitration under Rule 347(b) of the NYSE since it did not arise "out of the employment or termination of employment" of plaintiff as a registered representative by the defendant; and (2) he is not a "member" of the Exchange, as defined in § 3(a)(3) of the 1934 Act, 15 U.S.C. § 78c(a)(3) (1970), neither is he bound by §28(b)(2) of the 1934 Act, 15 U.S.C. § 78bb(b)(2) (1970), and therefore § 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a) (1970), rendering unenforceable prospective agreements to arbitrate, controls rather than the exemption provisions as contained in § 28(b) of the 1934 Act. 15 U.S.C. § 78bb(b) (1970).

I.

Plaintiff and defendant are essentially in agreement on most of the facts as previously recorded, but are at odds pertaining to the characterization of the dispute and the role to be served by the NYSE regarding arbitration. Ayres most vigorously asserts that the obligation owed to him by the defendant arose not from his association with Merrill Lynch as an employee, but instead stemmed from the fiduciary duties existing between a purchaser and seller of securities. In other words, as an owner of stock plaintiff was entitled to know about Merrill Lynch's decision to go public even though, as plaintiff concedes, this same information need not have been disclosed to other employees of the defendant who owned no stock.

As a discussion of the relevant cases will subsequently demonstrate, plaintiff's position is indeed unique in that (1) although Ayres is a registered representative of NYSE, the current controversy does not clearly and squarely relate to the business functions and commercial transactions normally engaged in by a registered representative of the Exchange in the performance of his prescribed duties; and (2) Ayres is not a member of the Exchange as has been true in most of the applicable cases. Notwithstanding the plaintiff's atypical circumstances there is one factor evident in this case which I deem to be particularly compelling and dispositive, and thus dictates the result which I herein reach today. That is, Ayres was initially permitted to purchase the shares of Merrill Lynch only because he was one of its employees. Moreover, Ayres' decision to retire when he did might have precipitated Merrill Lynch's exercising its re-purchase option and hence the Court is further confronted with a dispute which arose not only out of the course of employment of a registered representative, but additionally stemmed from the termination of that employment.[3]

In examining the Stock Subscription Agreement it appears that the defendant's decision to sell stock to Ayres was premised on Ayres' status as an employee. More specifically, the Agreement states:

> "Whereas, the Purchaser is an employee of the Corporation or of another corporation controlled directly or indirectly by the Corporation, and the

[3] In this regard, the Court is mindful of plaintiff's contention that his retirement at that time was indeed voluntary and that he was physically capable of working for a longer period. Further, the Court is aware that the alleged breach of the fiduciary obligations in question occurred prior to, and was continuing at the time of, plaintiff's tendering his offer of resignation.

> Corporation desires to make available to the Purchaser an opportunity to purchase shares of its Non-voting Common Stock, and the Purchaser desires to purchase such shares, upon the terms and conditions hereinafter set forth:"

Paragraph 6 of the Agreement further stipulates that the Agreement was not assignable by the Purchaser.

Neither plaintiff's complaint nor any of the supporting or opposing papers filed in this case, discloses what other attempts, if any, were undertaken by Merrill Lynch to re-purchase stock from other employees during this period (July 1970 through June 23, 1971) and how many employees owning stock of defendant retired during this time.

The facts in this case are remarkably similar to Ryan v. J. Walter Thompson Co., 322 F.Supp. 307 (S.D.N.Y. 1971), aff'd 453 F.2d 444 (2d Cir. 1971), cert. denied 406 U.S. 907, 92 S.Ct. 1611, 31 L.Ed.2d 817 (1972), though there are factual discrepancies. In *Ryan*, the plaintiff had purchased stock from the defendant at a time when the stock was sold only to its officers and employees. Whenever the stockholder desired to sell or terminate his employment or vacate his office, the defendant could repurchase the stock. Three years after Ryan had retired from the defendant, the defendant decided to go public and exercised its option to repurchase the plaintiff's shares. Although the defendant there, as in the instant case, did not disclose its intentions of having a public offering prior to the repurchase, the Court of Appeals concluded there were no anti-fraud violations under Rule 10b-5, since the plaintiff was obligated to sell irrespective of what he knew or did not know. 453 F.2d at 447. While the *Ryan* case does contain comparable facts, it can be distinguished as respects defendant's motion

here, because that case did not specifically address itself to the question of arbitration and consequently, it was permitted to proceed to a conclusion on the merits in Court. A reading of *Ryan* does not reflect whether either party requested arbitration or, if requested, whether arbitration would have been proper under the circumstances, since Ryan was not a member of the Exchange or a registered representative.

Fershtman v. Schectman, 450 F.2d 1357 (2d Cir. 1971) cert. denied, 405 U.S. 1066, 92 S.Ct. 1500, 31 L.Ed.2d 766 (1972), is again another case, which goes to the merits of the instant dispute rather than to an analysis of the applicability of the arbitration clause provided in Rule 347(b).

Isaacson v. Hayden, Stone, Inc., 319 F.Supp. 929 (S.D.-N.Y. 1970) will be examined at this juncture, although later sections of the opinion will more extensively consider plaintiff's contention that he was not a member of the Exchange as defined in § 3(a)(3) of the 1934 Act, neither was he bound by § 28(b)(2) of the 1934 Act. In *Isaacson,* the Court held that a dispute was arbitrable in accordance with the rules of the NYSE, even though at the time plaintiff therein initiated the action he was no longer a member of the Exchange. In that case, the plaintiff an allied member of NYSE and an officer of the defendant, purchased shares of stock from Hayden, Stone, also a member of NYSE. The controversy revolved around defendant's obligation to repurchase plaintiff's stock upon the latter's retirement. The Court took notice of the fact that as *members* of the Exchange they had agreed to arbitrate any controversy arising between them. Furthermore, the Court stated at pages 929-930 of 319 F.Supp:

> "The controversy in this suit arises out of and relates directly to defendant's business as a member

> of the New York Stock Exchange and defendant's obligations to public customers and others in relation to its obligation to plaintiff."

The Court did not in any way feel the obligation to arbitrate had been impaired or destroyed because plaintiff had ceased to be a member of the Exchange. Instead, the dispute was arbitrable because "the controversy flows from and is predicated upon the business relationship between the parties which arose during their mutual membership in the Exchange." *Id.* at 930.

By virtue of Ayres' status as an employee of Merrill Lynch he was enabled to acquire shares in the defendant subject to the restrictions embodied in the purchase agreement, a binding contractual document consisting of provisions and covenants voluntarily entered into by each of the parties and legally enforceable by either of them. This commercial transaction which occurred between Ayres and Merrill Lynch can only be construed as arising out of the former's employment as a registered representative with Merill Lynch, even though Ayres acquired the securities for his own account and personal benefit and not as an intermediary for third parties.

Admittedly, the factual pattern in the case at bar is not of the same nature or of the same dimensions as the dispute in Dickstein v. duPont, 443 F.2d 783 (1st Cir. 1971), which involved a registered representative being compelled to arbitrate the adequacy of a "finder's fee" offered by a member of the Exchange. But dicta in *Dickstein* comes closest to scrutinizing the precise question raised by this litigation. Before undertaking a further analysis of *Dickstein,* it would be more appropriate, however, at this stage to spell out the countervailing federal policies which militate against a finding requiring arbitration, as well as articu-

lating the exemptions fashioned from those competing federal policies.

II.

A related argument against arbitration propounded by the plaintiff is that because he is not a member of the Exchange, as specified in § 3(a)(3) of the 1934 Act, 15 U.S.C. § 78c(a)(3) (1970)[4] and because he has not agreed to be bound by the Exchange pursuant to § 28(b)(2) of the 1934 Act, 15 U.S.C. § 78bb(b)(2) (1970),[5] the agreement to submit to arbitration Rule 10b-5 claims is unenforceable under § 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a) (1970).[6]

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[4] § 3(a)(3) of the 1934 Act specifically states:

"The term 'member' when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm."

[5] Section 28(b) reads:

"Nothing in this title shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this title, or the rules and regulations thereunder."

[6] Section 29(a) provides:

"Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

Wilko v. Swan, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), a leading case construing the applicability of arbitration enforcement under § 14 of the Securities Act of 1933, 15 U.S.C. § 77n (1970) (§ 14's wording and scope are comparable to § 29(a) of the 1934 Act), denied enforcement of an agreement executed between a customer and a brokerage firm, which required all controversies arising out of the sales transaction to be submitted to arbitration. The rationale of the decision was that the 1933 Act was designed to protect the public investors and place them on an equal footing with the issuers of and dealers in securities, the latter being in a better position to appraise the merits of the particular securities transaction. The right to select a judicial forum was deemed to be so fundamental that it could not be waived by the security purchaser prior to a violation of the Securities Act.

Beginning with Brown v. Gilligan, Will & Co., 287 F.Supp. 766 (S.D.N.Y. 1968), the Courts have carved out an exemption from § 29(a) for members of the Exchange. See also, Coenen v. R. W. Pressprich & Co., 453 F.2d 1209 (2nd Cir. 1972), cert. denied 406 U.S. 949, 92 S.Ct. 2045, 32 L.Ed.2d 337 (1972) [Arbitration required in action by an allied *member* (alleging, *inter alia*, § 10(b) violations) against a *member* firm]; Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838 (2nd Cir. 1971) (Defendant *non-member*, broker-dealer firm, in a suit raising § 10(b) claims, can *voluntarily* submit to arbitration and compel arbitration over objections of plaintiff-*member* firm); Revenue Properties Litigation Cases v. Cohn, Delaire & Kaufman, 451 F.2d 310 (1st Cir. 1971) (Both parties were broker-dealer *members* and arbitration was granted); Isaacson v. Hayden, Stone, Inc., *supra*.

[1] The Court is in complete accord with the reasoning of *Brown, supra,* and adopts it in this case. § 28(b)(1) of the 1934 Act does exempt arbitration agreements between members of the Exchange from the coverage of § 29(a). But since Ayres is not a member of the Exchange and has not voluntarily waived his right to sue in a federal forum and thus submit to arbitration, see *Axelrod & Co., supra;* Moran v. Paine, Webber, Jackson & Curtis, 389 F.2d 242 (3rd Cir. 1968) (Stock purchaser voluntarily submitted to arbitration and was thereafter precluded from suing in federal court), the additional question which remains is whether under Rule 347(b) Ayres is exempted from § 29(a) and is bound by § 28(b)(2).

One reading of § 28(b)(2) encompasses *Moran, supra,* and *Axelrod & Co., supra,* situations where once an alleged securities infraction has occurred, then the non-member reserves the right either to proceed initially in Court or, conversely, can voluntarily forego that right and allow the matter to be submitted to arbitration. That is, after being fully apprised of grounds and facts which, *inter alia,* would give rise to possible Rule 10b-5 violations, the non-member can then agree to be bound by the Exchange. *Accord,* 2 A. R. Bromberg, Securities Law §§ 12.10(2) and 12.10(6), pp. 287-288.1, 290 (1968); 3 L. Loss, Securities Regulation 1811-1817 (1961); 6 L. Loss, Securities Regulation 3932-3937 (1969).

Returning now to *Dickstein, supra,* the Court there found the registered representative's reliance upon Wilko v. Swan, *supra,* to be misplaced since Dickstein had not purchased any securities, an understandable pre-requisite to invoking the holding of that case. In commenting upon

the operative effect of § 28(b)(2) and its relationship to Rule 347(b) the Court in a footnote remarked:

> "... While clause (2) may refer to the agreement of a third person to be bound by a decision settling a dispute between members, it may arguably cover an agreement by a member's employee to be bound by an exchange decision settling his own dispute." *Dickstein, supra,* 443 F.2d at 787, note 5.

[2] In being employed as a registered representative, the plaintiff pursuant to Rule 347(b) has assented to arbitrate all disputes between himself and members of the Exchange which arise out of his employment or the termination of that employment. I find that where you have a registered representative who purchases securities from an employer-member firm *solely* because of his status as an employee, then that transaction is one which arises out of the course of that employment and can be referred to arbitration under Rule 347(b) and § 28(b)(2) of the 1934 Act, even though the controversy would otherwise not touch upon or concern the performance of the plaintiff's duties as a registered representative *qua* registered representative and the plaintiff's position would be analogous to that of a public investor.

The case at bar is not one where the securities purchaser, contemporaneously with the acquisition of the stock, executed an agreement prospectively waiving all rights to select a judicial forum for the resolution of any matters stemming from that transaction. Wilko v. Swan, *supra.* The requirement of arbitration here bears no relationship to Ayres' acquisition of the stock from Merrill Lynch, but arises from Ayres' consent under Rule 347(b) to arbitrate

employment-related disputes. *Cf.* Revenue Properties Litigation Cases v. Cohn, Delaire & Kaufman, *supra,* 451 F.2d at 313; *Coenen, supra,* 453 F.2d at 1211-1214; *Axelrod, supra,* 451 F.2d at 840-843; *Brown, supra,* 287 F.Supp. at 769-775.

I recognize that the knowledge and expertise which Ayres possessed and attained over the years as a result of his employment as a registered representative still might not be commensurate with that of a member of the Exchange, particularly in a transaction such as here where material facts pertaining to Merrill Lynch stock were allegedly not disclosed either to stockholders or employees. But the previous statement is partially negated because of Rule 347(b) and because Ayres would never have even been permitted to acquire the securities but for his status as an employee of Merrill Lynch. The plaintiff truly stands in an anomalous posture. Although Rule 10b-5 claims are significant and are of fundamental importance to the securities industry, nonetheless, the questions posed do not lie beyond the purview of an arbitrator's province. Revenue Properties Litigation Cases, *supra,* 451 F.2d at 313-314.

[3] To recapitulate, Ayres is being compelled to arbitrate his Rule 10b-5 claims solely because of his standing as a registered representative and his previously assenting to arbitrate all disputes which arise out of his employment or the termination of that employment pursuant to Rule 347(b) of the New York Stock Exchange. The acquisition of the shares in question came about only because of Ayres' status as an employee, and thus the transaction did arise out of his employment. Further, Rule 347(b) is an exception to § 29(a) of the 1934 Act and is therefore within the ambit

of § 28(b)(2) of the 1934 Act. Finally, I specifically make no finding as to whether an employee of a member of the Exchange, but who is not a registered representative, would be compelled to arbitrate controversies which arose from a securities purchase merely, as is additionally one of the facts here, because the buyer pledged himself to be bound by the Constitution and Rules of the Board of Governors of the Exchange and any amendments thereto, when that purchaser applied for approval as a holder of non-voting stock of a member of the Exchange in accordance with Article IX, Section 7 of the Constitution of the New York Stock Exchange.

[4] In ruling that this matter must be submitted to arbitration, my decision now should not in any way be construed as my making a judgment on the merits or intimating any view as to what the ultimate disposition of this case should be. I might add, however, that an employee-stockholder should be entitled to the performance of the identical fiduciary obligations by the securities seller that would be owed to a customer stockholder, but that is not to say the fiduciary duties in the case at bar, in fact, were or were not breached. I assume that the arbitrator will of course consider the total equities involved and arrive at a result which is both just and fair for all the parties concerned.

Consistent with the foregoing discussion, defendant's motion for a stay is granted.

Appendix C—Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

THIRD CIRCUIT

No. 75-2007.

PERCY D. AYRES,

Appellant,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

Appellee.

Argued March 11, 1976.
Decided June 28, 1976.

DAVID L. GROVE, Philadelphia, Pa., *for appellant;* FRANK S. DEMING, MONTGOMERY, MCCRACKEN, WALKER & RHOADS, Philadelphia, Pa., *of counsel.*

C. CLARK HODGSON, JR., STRADLEY, RONON, STEVENS & YOUNG, Philadelphia, Pa. and ROGER J. HAWKE, BROWN, WOOD, IVEY, MITCHELL & PETTY, New York City, *for appellee.*

HARVEY L. PITT, *Gen. Counsel,* PAUL GONSON, *Associate Gen. Counsel,* FREDERIC T. SPINDEL, *Asst. Gen. Counsel,* MARTIN S. BERGLAS, *Atty.,* S. E. C., Washington, D. C., amicus curiae.

Before: VAN DUSEN and WEIS, *Circuit Judges,* and STERN, *District Judge.*

Appendix C—Opinion of the Court of Appeals

OPINION OF THE COURT

VAN DUSEN, *Circuit Judge.*

This is an appeal from a district court judgment entered July 7, 1975, confirming a decision rendered by arbitrators of the New York Stock Exchange ("NYSE"). The principal question involves the applicability and validity of an Exchange arbitration rule in the context of a dispute arising under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[1] For the reasons set forth below, we vacate the judgment of the district court and remand for further proceedings.

During a period from 1945-1970, plaintiff-appellant, Percy D. Ayres, was employed as a registered representative or "account executive" with the firm of Merrill Lynch, Pierce, Fenner & Smith, Inc., a well-known broker-dealer. Through various stock purchases and stock dividends, Ayres became the owner of 8,000 shares of Merrill Lynch common stock. In connection with his original and subsequent purchases, Ayres entered into agreements with Merrill Lynch which, *inter alia,* gave Merrill Lynch an option, exercisable for any reason on 90 days' notice, to repurchase all or any part of such stock held by Ayres. Merrill Lynch stock was not publicly owned during the period, and Ayres was permitted to own the stock solely because of his status as an employee.

The complaint alleged that, in the spring of 1970, Merrill Lynch began actively to explore the possibility of making a

[1] 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (1975). Jurisdiction is based on § 27 of the Act, 15 U.S.C. § 78aa, and on 28 U.S.C. § 1332. The amount in controversy, exclusive of interest and costs, exceeds $10,000.

public offering of its stock. By July, the corporation's management had made an initial decision to go public and was taking preliminary steps towards accomplishing that goal. During the late summer, Ayres, who was ignorant of the planned offering which had not been publicly announced and who was under the impression that he would be permitted to retain his 8,000 shares of stock, advised Merrill Lynch of his intention to retire on October 1, 1970.[2]

Advised by a fellow employee of the possibility that Merrill Lynch would exercise its 90-day options upon his retirement, Ayres approached a Merrill Lynch vice president to inquire about the firm's plans. The vice president told Ayres that he would take up the matter with the corporation's executives in New York and subsequently reported that Ayres would, in fact, be required to sell his stock if he chose to retire. Neither the vice president with whom Ayres spoke nor any other representative of Merrill Lynch informed Ayres of the prospective public offering. Unaware of the firm's plans, Ayres decided, on the basis of available information, to retire and thus to sell his 8,000 shares. Merrill Lynch subsequently purchased Ayres' stock for $209,064.

Asserting that Merrill Lynch had "wrongfully concealed" material non-public information in connection with the purchase and sale of securities, in violation of 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5, Ayres commenced this action on December 13, 1971, seeking rescission of the sale

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[2] Although Ayres had turned 65 in 1967, he had decided at that time to take advantage of Merrill Lynch's retirement policy under which he could remain in the firm's employ on a year-to-year basis until he attained the age of 70. Ayres retired at the age of 67, two days before his 68th birthday.

and/or damages. The theory of Ayres' complaint, which alleged violation of the anti-fraud provisions of the Securities Exchange Act and of state law, was that (1) in the absence of his voluntary retirement, Merrill Lynch would not have exercised its repurchase option, and (2) if he had known of the information Merrill Lynch "concealed," he would have chosen not to trigger the sale by postponing his retirement.[3]

Defendant Merrill Lynch responded to the complaint by moving, pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 3,[4] for a stay of proceedings pending arbitration. Specifically, Merrill Lynch, a member firm of the NYSE asserted that the dispute was "[a]ny controversy . . . arising out of [Ayres'] employment or termination of employment" and was, therefore, subject to compulsory arbitration under Stock Exchange Rule 347(b) by which both Ayres and Merrill Lynch had agreed to be bound when Ayres became a registered representative in 1945.[5] In answer to the argument that agreements to arbitrate future federal securities controversies are "void" under the anti-waiver provision of the Securities Exchange Act, 15 U.S.C.

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[3] *Cf. St. Louis Union Trust Co.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 412 F.Supp. 45 (E.D.Mo., Findings, Conclusions and Judgment of March 24, 1976), at pp. 5, 20, 22, 26, 30, & 31 of typed Findings and Conclusions. At page 49 of the opinion, the court found that Merrill Lynch "had no uniform policy in exercising the options to purchase stock at retirement . . . of a stockholder."

[4] Ayres has never contended that the arbitration agreement does not fall within the ambit of 9 U.S.C. §§ 1, 2. See *Dickstein* v. *duPont*, 443 F.2d 783, 784-85 (1st Cir. 1971). See also *Gavlik Constr. Co.* v. *H. F. Campbell Co.*, 526 F.2d 777, 784-85 (3d Cir. 1975).

[5] At the time Ayres became a registered representative, he filed with the Exchange an application for approval of his employment with Merrill Lynch. As part of that application he agreed to be bound by existing Exchange rules and all amendments thereto. Exchange Rule 347(b) was adopted in 1958.

§ 78cc(a) and *Wilko* v. *Swan,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), Merrill Lynch contended that Exchange Rule 347(b) fell within the compass of § 28(b), which exempts, *inter alia,* certain stock exchange "action" from the invalidating effect of the anti-waiver provision. See 15 U.S.C. § 78bb(b).

The district court agreed with Merrill Lynch's contentions that Exchange Rule 347(b) was applicable on its face and was exempt from the anti-waiver provision of the Act. Accordingly, by opinion and order dated January 19, 1973, the court stayed all proceedings pending arbitration.[6] The arbitrators, without stating reasons, subsequently rendered a decision adverse to Ayres on all claims, and the district court confirmed this decision in a final judgment entered July 7, 1975. This timely appeal followed.

In our view, the primary question presented by this appeal concerns the district court's conclusion that the arbitration agreement embodied in Exchange Rule 347(b) governs this controversy. That Rule provides:

> "Any controversy between a registered representative and any . . . member organization arising out of the employment or termination of employment of such registered representative by and with such . . . member organization shall be settled by arbitration, at the instance of any such party, in accordance with the arbitration procedure described elsewhere in these rules."

[6] The district court opinion is reported at 353 F.Supp. 1084 (E.D.Pa. 1973). A timely appeal from the January 19 order was dismissed for lack of the requisite finality. See Order filed May 1, 1973 (Document No. 16, E.D.Pa., Civil No. 71-2986) and April 27, 1973, order of this court at No. 73-1231. As noted above, the complaint seeks rescission and/or money damages. See *Stateside Machinery Co.* v. *Alperin,* 526 F.2d 480, 484-85 (3d Cir. 1975), and cases cited therein.

Acknowledging that the present controversy "does not clearly and squarely relate to the business functions and commercial transactions normally engaged in by a registered representative of the Exchange in the performance of his prescribed duties,"[7] the district court nevertheless concluded that the dispute in this case was "any controversy . . . arising out of [Ayres'] employment or termination of employment" with Merrill Lynch and hence fell within the purview of Exchange Rule 347(b). The exclusive basis for this determination was the fact that Ayres was initially permitted to purchase Merrill Lynch stock solely because of his status as an employee. *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, supra,* 353 F.Supp. at 1087, 1091.

[1] Although we find the question not free from doubt, we do not think that Exchange Rule 347(b) was intended to cover a controversy that has a causal connection to the fact of employment as remote as that involved in this disput. All of the cases that have applied Exchange Rule 347(b) concerned the terms of the consensual relationship between registered representatives and Exchange members and the respective rights and duties of the parties as employer and employee.[8] While we have no occasion to mark

[7] *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith,* 353 F.Supp. 1084, 1087 (E.D.Pa. 1973). The district court also stated that, except for the fact that Ayres was permitted to purchase the stock *"solely"* because of his status as an employee, "the controversy would otherwise not touch upon or concern the performance of the plaintiff's duties as a registered representative *qua* registered representative and the plaintiff's position would be analogous to that of a public investor." *Id.* at 1091.

[8] See *e.g., Stokes* v. *Merrill Lynch, Pierce, Fenner & Smith,* 523 F.2d 433 (6th Cir. 1975); *Dickstein* v. *duPont,* 443 F.2d 783 (1st Cir. 1971); *Isaacson* v. *Hayden, Stone, Inc.,* 319 F.Supp. 929 (S.D.N.Y. 1970); *Moritz* v. *Francis I. duPont & Co.,* 291 Minn. 523, 189 N.W.2d 487 (1971).

the bounds of Exchange Rule 347(b), we believe the Rule was primarily designed to cover such disputes and that the present controversy falls outside the perimeter of the rule.

In our view, the dispute here has its primary genesis in an alleged securities fraud and concerns Ayres' rights under federal and state securities laws as a stockholder and as a seller of securities. It does not center on Ayres' rights as a former employee under any consensual arrangement relating to the terms and conditions of his employment or termination. Although, in a purely factual sense, the claims are connected with the termination of employment, the legal rights being asserted have a source wholly independent of the employment relationship. Arbitration is a matter of contract, and we do not think Ayres can reasonably be understood to have waived his right to judicial trial of such claims.

[2] The Supreme Court has characterized Exchange Rule 347(b) as relating to the "exchange's housekeeping affairs" and has suggested it deals primarily with "the area of wage claims." *Merrill Lynch, Pierce, Fenner & Smith,* v. *Ware,* 414 U.S. 117, 136, 94 S.Ct. 383, 38 L.Ed.2d 348 (1973). To conclude that the Rule applied under the unusual circumstances of this case would be, in our view, to stretch the Rule well beyond those goals. Here the arbitrators would be called upon to apply legal precepts whose importance transcends the Exchange's interests in self-governance and to draw upon far more than the specialized knowledge of industry needs and practices that makes arbitration appropriate when the terms and conditions of the employment relationship are at issue. *Cf. Alexander* v. *Gardner-Denver Co.,* 415 U.S. 36, 56-57, 94 S.Ct. 1011, 39 L.Ed.2d 147 (1974). Moreover, the Securities and Exchange Commission, which now has jurisdiction to amend,

modify or repeal any Exchange rule, opposes any construction which would make Exchange Rule 347(b) applicable under the circumstances of this case. See 15 U.S.C. § 78s(b). *Compare Merrill Lynch, Pierce, Fenner & Smith* v. *Ware, supra,* 414 U.S. at 129-131, 94 S.Ct. 383. See page 538 below.

[3] Our conclusion that Exchange Rule 347(b) is inapplicable here is buttressed by the fact that even if Exchange Rule 347(b) was intended to govern controversies such as this, we believe it would, in any event, be unenforceable and invalid as applied to this case.[9] In *Wilko* v. *Swan,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), the Supreme Court held that the anti-waiver provision of the Securities Act of 1933, 15 U.S.C. § 77n, which is almost identical to § 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a),[10] rendered "void" a prospective agreement between a brokerage firm and a customer which would have required arbitration of the customer's claim under § 12(2) of the 1933 Act. We

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[9] The existence of countervailing federal policies, see *Wilko* v. *Swan, supra,* makes cases showing an hospitable attitude to the construction of arbitration clauses inapposite. For example, *United Steelworkers of America* v. *Warrior & Gulf Navigation Co.,* 363 U.S. 574, 80 S.Ct. 1347, 4 L.Ed.2d 1409 (1960), on which Merrill Lynch principally relies, expressly terms "the run of arbitration cases, illustrated by *Wilko* v. *Swan* . . . irrelevant." *Id.* at 578, 80 S.Ct. at 1351.

[10] Section 14 of the 1933 Act, 15 U.S.C. § 77n, provides:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

Section 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

need not review here the fundamental and important differences between litigation in a court and arbitration.[11] It is enough to say that the Supreme Court found prospective waivers of the right to judicial trial and review to be inconsistent with Congress' overriding concern for the protection of investors. *Wilko* v. *Swan, supra,* 346 U.S. at 437, 74 S.Ct. 182; see *Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506, 512, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). As Merrill Lynch points out, a "colorable argument can be made" that *Wilko* v. *Swan* should not apply to arbitration of judicially implied causes of action under the 1934 Act. We are not, however, persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrant such a distinction.[12] And we note that Congress appears to have accepted the view that *Wilko* v. *Swan* applies in the 10b-5 context. *Cf.* H.R.Rep.No.94-229, 94th Cong., 1st Sess., at 111 (1975), U.S.Code Cong. & Admin.News 1975, p. 321.

[4] Merrill Lynch contends that the anti-waiver provision of the Securities Exchange Act and the policy considerations articulated in *Wilko* are inapplicable here because

[11] See, *e. g. Alexander* v. *Gardner-Denver Co.,* 415 U.S. 36, 56-58, 94 S.Ct. 1011, 39 L.Ed.2d 147 (1974); *Wilko* v. *Swan, supra,* 346 U.S. at 435-37, 74 S.Ct. 182; *Bernhardt* v. *Polygraphic Co. of America,* 350 U.S. 198, 203 & n. 4, 76 S.Ct. 273, 100 L.Ed. 199 (1956).

[12] This "colorable argument" was mentioned, but not explored, in dicta in *Scherk* v. *Alberto-Culver Co., supra,* 417 U.S. at 513-14, 94 S.Ct. 2449, a 5-4 decision in which the Court accepted the premise that *Wilko* v. *Swan* was applicable. The Court noted that the 10b-5 cause of action is judicially implied, whereas § 12(2) expressly provides a private cause of action, and that the 1934 Act vests exclusive jurisdiction in the federal courts while the 1933 Act grants concurrent federal and state jurisdiction.

Ayres' complaint fails to state a claim for relief under the Act. Relying on *Ryan* v. *J. Walter Thompson Co.,* 453 F.2d 444 (2d Cir. 1971) (per curiam), *cert. denied,* 406 U.S. 907, 92 S.Ct. 1611, 31 L.Ed.2d 817 (1972), Merrill Lynch argues that the facts it failed to disclose concerning the planned public offering were not "material" from Ayres' standpoint because "regardless of what he knew or did not know," Ayres was, in any event, contractually obligated under the 90-day option agreement to sell his Merrill Lynch stock. See *Ryan* v. *J. Walter Thompson, supra,* 453 F.2d at 447. We disagree.

In *Ryan,* the plaintiff brought a 10b-5 action against his former employer which had exercised its contractual option to purchase his stock but had not informed him of its plans to go public. Because Ryan's sale was totally involuntary from his own point of view, the court concluded that the undisclosed facts were not material.[13] In the present case, this critical element of lack of choice on the plaintiff's part is lacking. According to the complaint, Ayres' voluntary decision to retire was also a voluntary decision to sell. The complaint alleges that Ayres could and would have elected not to retire and not to sell his stock had he known

[13] As Jennings and Marsh, citing *Ryan* v. *J. Walter Thompson, supra,* explain:

> "If the other party to the transaction has no choice in the matter, then no information is 'material' to him."

R. Jennings & H. Marsh, Securities Regulation, 1128 n. 33 (3d ed. 1972). See also *Fershtman* v. *Schectman,* 450 F.2d 1357, 1360 (2d Cir. 1971), *cert. denied,* 405 U.S. 1066, 92 S.Ct. 1500, 31 L.Ed.2d 796 (1972).

of Merrill Lynch's plans.[14] More significantly, before discussing the merits of the 10b-5 claim, the *Ryan* court noted its agreement with the district court's holding on summary judgment, that the repurchase option in that case was valid under New York law. Here, in contrast, the district court has made no such determination. Without intending to finally determine an issue on which the trial judge has yet to express a view, we note that arguments can be made that Merrill Lynch's option agreement, as exercised in this case, was invalid under either federal or state law and that the information Merrill Lynch failed to disclose was therefore material. See *St. Louis Union Trust Co.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., supra* note 3,

[14] The complaint (paragraphs 24, 33 and 34) alleges that "[h]ad plaintiff not retired on October 1, 1970, plaintiff would not then have been required to sell to defendant his stock of defendant, nor could he thereafter have been required to sell to defendant his stock of defendant if he remained in defendant's employ until . . ." June 23, 1971, when defendant removed from its common stock all restrictions and options effective one year after termination of the public offering of June 23, 1971. In *Ryan* (322 F.Supp. at 308), the allegation was that if the plaintiffs had known of Thompson's contemplated public offering approximately two years after his retirement, when the option was exercised, "they would not have made the sale" (not that Ryan would not have retired), which they were bound by contract to make. Furthermore, Ryan "indicated a knowledge of the possibility that Thompson would change its policy and have public stockholders," making its stock more valuable at the time he made the sale under the option, and wrote that the price he received was "gratifying" (322 F.Supp. at 310). Also, the district court found that when the option was exercised in January 1969 by Thompson, "Thompson was 100% employee owned and might so remain indefinitely" (322 F.Supp. at 314). The district court found that it was a "necessary" business policy for Thompson to exercise the options of employees retiring in 1966 and before if it were to go public (322 F.Supp. at 312).

at 20-28.[15] Under these circumstances, we believe the policies underlying *Wilko* v. *Swan* are fully applicable.

Merrill Lynch also argues that § 28(b) of the Securities Exchange Act exempts Exchange Rule 347(b) from the invalidating effect of the anti-waiver provision of the Act. As amended,[16] § 28(b) provides:

> "Nothing in this title shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, . . . or (3) of any action described in paragraph (1) . . . on any person who has agreed to be bound thereby."

Merrill Lynch argues that § 28(b)(3) operates to preserve the "binding effect" on Ayres of Exchange Rule 347(b). In their view, promulgation of Exchange Rule 347(b) constituted the type of "action" contemplated by the statute and Ayres is a "person who has agreed to be bound thereby."

[15] In *St. Louis Union Trust Co.* v. *Merrill Lynch, Pierce, Fenner & Smith*, the district court stated at page 56 that:

> "The nondisclosure was part of a scheme to maintain management control and to increase the per share earnings of Merrill Lynch stock prior to a public offering at the expense of plaintiffs and other non-employee shareholders. A means of accomplishing these purposes lay near at hand; exercising the corporation's option to call the stock of shareholders who had left the employ of Merrill Lynch through termination, retirement, or death."

The court held the option involved in that case was unenforceable.

[16] Section 28(b) was amended by § 21(1) of the Securities Acts Amendments of 1975, 89 Stat. 160. Since the amendment does not affect the substance of the section in any way pertinent to this case, we have set out the section as it presently reads.

[5, 6] We agree with Merrill Lynch that the term "action taken by the authorities . . . to settle disputes between members or participants" includes Exchange "action" in prescribing compulsory arbitration rules and is not limited to the actions of Exchange arbitrators in settling preexisting disputes. See *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 451 F.2d 838, 841 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.,* 287 F.Supp. 766, 774 & n. 18 (S.D.N.Y. 1968); 15 U.S.C. § 78c(a) (3) (26) (Supp. I 1976). But the mere fact that Ayres agreed to be bound by Exchange Rule 347(b) is not enough to bring that Rule within the exemptive provisions of § 28(b). Under the plain language of the statute, Exchange "action . . . to settle disputes *between members or participants*" (emphasis added) is a prerequisite to application of § 28(b). Here that ingredient is missing. Exchange Rule 347(b) addresses controversies between registered representatives and member firms, not "disputes between members or participants." And it is undisputed that Ayres is not and has never been a "member of or participant in any self-regulatory organization" for purposes of § 28(b).[17]

Our construction of § 28(b) is mandated by the plain and unambiguous language of the statute. It is, as well, the interpretation suggested by the Securities and Exchange Commission, which has appeared in this case as amicus curiae. As the agency charged with the duty of administering the Securities Exchange Act and of supervising the stock exchanges' regulatory procedures, its view is to be given consideration. See, *e. g. Saxbe* v. *Bustos,* 419 U.S. 65, 74, 95 S.Ct. 272, 42 L.Ed.2d 231 (1974).

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[17] See 15 U.S.C. § 78c(a)(3)(A) (Supp. I 1976) (definition of member); 15 U.S.C. § 78c(a)(3)(24) (Supp. I 1976) (definition of participant).

The only case whose holding is arguably inconsistent with the view we have taken is *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 451 F.2d 838 (2d Cir. 1971). But see *Newman* v. *Shearson, Hammill & Co.,* 383 F.Supp. 265 (W.D.Tex. 1974). But the court in *Axelrod* did not discuss the question of whether § 28(b) was limited to "disputes between members" and decided the question *sub silentio,* without apparent recognition of the problem. Moreover, *Axelrod* is distinguishable on both factual and policy grounds.[18] See *Newman* v. *Shearson, Hammill & Co., supra,* 383 F.Supp. at 268-69.

For all of the foregoing reasons, including our view of the applicable federal policies, we conclude that Exchange Rule 347(b) did not require arbitration of the present controversy. Accordingly, we vacate the July 7, 1975, judgment and remand for further proceedings consistent with this opinion.[19]

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[18] *Axelrod* involved a dispute between a member and a non-member firm. The non-member had instituted arbitration proceedings under Article VII, § 1, of the NYSE Constitution after a contract dispute had arisen. The member firm attempted to avoid the binding effect of the Constitution by commencing a federal court action and seeking to rescind the contract because of alleged securities violations. Against that background the court stated at pp. 842-43 of 451 F.2d:

> "[T]he policy considerations relied on by the Supreme Court in *Wilko* are inapposite here, the Supreme Court found that the non-waiver provision there involved was designed to protect investors. 346 U.S. at 431, 74 S.Ct. 182. Without such provision, financial houses might escape statutory liability by taking advantage of the inferior bargaining position of customers. But the legislative policy of protecting investors will not be thwarted by compelling an exchange member to arbitrate, at the instance of a nonmember, a dispute which is arbitrable under the exchange's constitution."

[19] Because the arbitrators were without any jurisdiction, we reject Merrill Lynch's argument based on res judicata and collateral estoppel. See Restatement of Judgments (1942), § 7.

STERN, *District Judge* (dissenting).

Percy Ayres became a registered representative with Merrill Lynch in 1945. For the next 25 years he worked as a professional dealer in securities. At the time he was hired, he agreed to submit to the jurisdiction of the New York Stock Exchange and to be bound by the rules of the Exchange and all amendments thereto. He reaffirmed that agreement in 1961, when he applied for Exchange approval to become the holder of Merrill Lynch non-voting common stock. Ayres purchased a total of 2,000 shares of Merrill Lynch in two separate transactions in January 1962 and December 1964. The total purchase price was $49,741.50. With each purchase Ayres executed a Stock Subscription Agreement under which Merrill Lynch reserved the absolute right at any time to repurchase any or all of Ayres' stock on 90-days' notice. As the majority notes, *ante* at 533, the option to repurchase was exercisable for any reason. Over the years Ayres' stock split several times, and on the date of his retirement he held 8,000 shares. Merrill Lynch exercised its repurchase option when Ayres retired on or about October 1, 1970, and required Ayres to sell his stock to Merrill Lynch for $209,064.00.

The gravamen of Ayres' claim is his allegation that Merrill Lynch withheld from him the information that it was planning to go public. Ayres contends that if the corporation had informed him of the upcoming public offering he would have decided not to retire in the hope of realizing still greater appreciation of his stock. He claims that his decision not to retire would have caused Merrill Lynch not to exercise its admittedly absolute and unqualified right to repurchase. Thus, according to Ayres, Merrill Lynch withheld from him material information in connection with his sale of stock to Merrill Lynch, in violation of Rule 10b-5.

I am unable to concur in the Court's opinion. I cannot agree that this complaint states a claim under Rule 10b-5, and I therefore find the Court's analysis of *Wilko* v. *Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), inapplicable.

Congress intended, in enacting section 10(b), "to eliminate deceptive and unfair practices in security trading and to protect the public from inaccurate, incomplete and misleading information. The thrust of the Act and the decisions interpreting it is to give the investing public the opportunity to make knowing and intelligent decisions regarding the purchase or sale of securities." *Kahan* v. *Rosenstiel*, 424 F.2d 161, 173 (3rd Cir. 1970). *Cf. Ernst & Ernst* v. *Hochfelder*,— U.S. ——, 96 S.Ct. 1375, 47 L.Ed.2d 668, 44 U.S.L.W. 4451, 4454 (1976). This Court held in *Rochez Bros., Inc.* v. *Rhoades*, 491 F.2d 402, 408 (3rd Cir. 1974):

> The test of the materiality of undisclosed or misrepresented facts is basically an objective one—i. e., whether "a reasonable man would attach importance [to them] in determining his choice of action in the transaction in question." *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2nd Cir.), cert. denied, 382 U.S. 811 [86 S.Ct. 23, 15 L.Ed.2d 60] (1965).

The majority properly observes, *ante* at 537, n. 13, that no information can be material to the exercise of a party's choice of action if that party has no choice to make. It is the majority's view, however, that "this critical element of lack of choice on the plaintiff's part is lacking" here. *Ante*, at 537. I cannot join in this assertion. No party

contends that Merrill Lynch had anything less than an unfettered right to require Ayres to sell his stock at any time on 90-days' notice. He had no right to refuse to sell. Merrill Lynch had an unconditional contractual right to buy at any time and for any reason. Thus, Ayres had no "choice of action" with regard to the sale of his stock to Merrill Lynch. I fail to see how he could have a right to any information before the sale, or how he could be prejudiced by the lack of such information.*

To the extent that Ayres had any choice to make, it was not a decision to sell securities. The decision was whether to retire or not. This decision, and this alone, was what would have been influenced by the information which Ayres claims was withheld by Merrill Lynch. *See Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975); *Landy* v. *FDIC,* 486 F.2d 139 (3rd Cir. 1973), *cert. denied,* 416 U.S. 960, 94 S.Ct. 1979, 40 L.Ed.2d 312 (1974). In my view any controversy concerning this decision is one "arising out of the employment or termination of employment" of Ayres with Merrill Lynch, and is governed by Exchange Rule 347(b).

The assertion in the complaint that Ayres' decision to retire amounted to a decision to sell his stock, because it influenced Merrill Lynch's decision to exercise its option to repurchase, is well answered by the Second Circuit's opinion in *Ryan* v. *J. Walter Thompson Co.,* 453 F.2d 444

* The majority's suggestion *ante* at 537, "that arguments can be made that Merrill Lynch's option agreement, as exercised in this case, was invalid under either federal or state law and that the information Merrill Lynch failed to disclose was therefore material" is puzzling. No such claim appears on the face of the complaint. No such claim was ever made to the district court. No such claim has been made in brief or argument to this Court.

(2nd Cir. 1971), *cert. denied,* 406 U.S. 907, 92 S.Ct. 1611, 31 L.Ed.2d 817 (1972). In that case the court began with an observation equally apposite here:

> This case is another example of a trend we have observed with disturbing frequency, namely, the invocation of the salutary anti-fraud provisions of the federal securities laws in cases where those provisions are wholly inappropriate and wide of the Congressional mark.

453 F.2d at 445.

The court held that an employee-stockholder's lack of knowledge of his company's plans to go public, under circumstances similar to those before us, could afford him no basis for relief under Rule 10b-5:

> With respect to the Rule 10b-5 claim, the District Court held that, since Ryan was obligated to sell his shares to JWT in January 1969, whatever he knew or did not know regarding JWT's plans to go public was irrelevant. We agree. See *Fershtman* v. *Schectman,* 450 F.2d 1357, 1350 (2nd Cir. 1971).

453 F.2d at 447.

Under the facts alleged in this complaint, I would apply the *Ryan* rule and affirm.

For the foregoing reasons, I respectfully dissent.

Appendix D—Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 75-2007

PERCY D. AYRES,

Appellant,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

Appellee.

(D. C. Civil Action No. 71-2986)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present:

VAN DUSEN and WEIS, *Circuit Judges,* and STERN, *District Judge*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed July 7, 1975, be, and the same is hereby vacated and the cause is remanded for further proceedings consistent with the opinion of this Court.

Attest:

THOMAS F. QUINN

Clerk

June 28, 1976

Appendix E—Order of the Court of Appeals Sur Petition For Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 75-2007

PERCY D. AYRES,

Appellant,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

Appellee.

(D. C. Civil No. 71-2986)

Present:

SEITZ, *Chief Judge,* and VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER, WEIS and GARTH, *Circuit Judges.*

SUR PETITION FOR REHEARING

The petition for rehearing filed by appellee in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

VAN DUSEN

Judge

Dated: July 22, 1976

Supreme Court, U. S.
FILED
NOV 11 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1976.

No. 76-550.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

PERCY D. AYRES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW.

1. Should this Court entertain matters presented by interlocutory petition which proceedings in the United States District Court for the Eastern District of Pennsylvania and the United States Court of Appeals for the Third Circuit hereafter might render moot, and which are of limited effect in any event?

2. Did not the Court of Appeals correctly determine that:

a. Rule 347(b) of the New York Stock Exchange ("Exchange") was not intended to cover claims under federal and state securities laws by a registered representative employed by an Exchange member that the member had defrauded the representative as a stockholder and seller of the member's stock to the member?

b. Even if Rule 347(b) were intended to govern such controversies, it would in any event be unenforceable and invalid as applied to this case?

COUNTER-STATEMENT OF THE CASE.

The pertinent facts of this case are summarized in the opinion of the Court of Appeals, as follows:

> "During a period from 1945-1970, plaintiff-appellant, Percy D. Ayres, was employed as a registered representative or "account executive" with the firm of Merrill Lynch, Pierce, Fenner & Smith, Inc., a well-known broker-dealer. Through various stock purchases and stock dividends, Ayres became the owner of 8,000 shares of Merrill Lynch common stock. In connection with his original and subsequent purchases, Ayres entered into agreements with Merrill Lynch which, *inter alia*, gave Merrill Lynch an option, exercisable for any reason on 90 days' notice, to repurchase all or any part of such stock held by Ayres. Merrill Lynch stock was not publicly owned during the period, and Ayres was permitted to own the stock solely because of his status as an employee.
>
> "The complaint alleged that, in the spring of 1970, Merrill Lynch began actively to explore the possibility of making a public offering of its stock. By July, the corporation's management had made an initial decision to go public and was taking preliminary steps towards accomplishing that goal. During the late summer, Ayres, who was ignorant of the planned offering which had not been publicly announced and who was under the impression that he would be permitted to retain his 8,000 shares of stock, advised Merrill Lynch of his intention to retire on October 1, 1970.[1]

1. Although Ayres had turned 65 in 1967, he had decided at that time to take advantage of Merrill Lynch's retirement policy under which he could remain in the firm's employ on a year-to-year basis until he attained the age of 70. Ayres retired at the age of 67, two days before his 68th birthday.

> "Advised by a fellow employee of the possibility that Merrill Lynch would exercise its 90-day options upon his retirement, Ayres approached a Merrill Lynch vice president to inquire about the firm's plans. The vice president told Ayres that he would take up the matter with the corporation's executives in New York and subsequently reported that Ayres would, in fact, be required to sell his stock if he chose to retire. Neither the vice president with whom Ayres spoke nor any other representative of Merrill Lynch informed Ayres of the prospective public offering. Unaware of the firm's plans, Ayres decided, on the basis of available information, to retire and thus to sell his 8,000 shares. Merrill Lynch subsequently purchased Ayres' stock for $209,064." (27a-29a)*

When Merrill Lynch went public some months thereafter, those shares, which in the interim were split 3 for 1, had a value of $672,000 (5a, ¶ 22).

Most of the factual allegations made by respondent against petitioner in this case have already been determined against petitioner in *St. Louis Union Trust Co., et al. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, 412 F. Supp. 45 (E. D. Mo., E. D., 1976).

In *St. Louis Union Trust Co.*, Chief Judge Meredith found that Merrill Lynch and certain of its officers and employees, in conscious disregard of plaintiffs' legal rights and owing plaintiffs a fiduciary duty, deliberately availed themselves of material inside information when Merrill Lynch repurchased its stock from plaintiffs prior to going public. In the circumstances Chief Judge Meredith found

* Page references to the appendices annexed to the petition are suffixed "a". Page references to the appendix annexed to this brief are suffixed "A".

that Merrill Lynch and the individual defendants violated section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U. S. C. 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C. F. R. § 240.10b-5; committed common law fraud; and breached their fiduciary duties.

St. Louis Union Trust Co. is presently on appeal to the United States Court of Appeals for the Eighth Circuit.

Respondent's detailed factual allegations appear in his Complaint (1a-9a) and in his Amendment to Complaint (1A), neither of which has been answered by petitioner. Petitioner did not include respondent's Amendment to Complaint in the appendices to the petition. It is annexed hereto at 1A.

Contrary to the assertion made in the footnote on page 7 of the petition, respondent's Complaint, as amended, alleges that petitioner wrongfully concealed material facts from respondent; that in repurchasing respondent's stock petitioner acted without any justifiable corporate purpose and for a fraudulent purpose; and that petitioner's conduct, as described in the Complaint, as amended, was malicious, willful and intentional.

REASONS FOR NOT GRANTING THE WRIT.

This Court Should Not Entertain Matters Presented by Interlocutory Petition Which Proceedings in the District Court and the Court of Appeals Hereafter Might Render Moot, and Which Are of Limited Effect in Any Event.

The Court of Appeals has remanded this case to the District Court for further proceedings consistent with the Court of Appeals' opinion. The District Court must now decide respondent's securities fraud claims on their merits. Respondent fully expects that the District Court will find for respondent and be upheld by the Court of Appeals. However, the District Court could conceivably hold against respondent and be sustained by the Court of Appeals. Alternatively, the District Court might find for respondent and be reversed by the Court of Appeals. There are thus many courses which this case might take hereafter, some of which would render unnecessary a decision by this Court in this case on the matters sought to be presented by petitioner at this time.

The decision of the Court of Appeals directly affects only respondent and petitioner. Conceivably, it might bear upon another case (i) arising in the Third Circuit, (ii) involving a registered representative employed by an Exchange member, (iii) who agreed to arbitrate only employment and termination of employment disputes, and (iv) who owned shares in the member, (v) which were not publicly traded, (vi) which were subject to a repurchase option, and (vii) which were repurchased by the member shortly before the member "went public", the member having fraudulently concealed its actual plans to do so from the representative. However, it has no broader application.

The Court of Appeals, having stated that it had ". . . no occasion to mark the bounds of Exchange Rule 347(b) . . . ," held only that the controversy between petitioner and respondent ". . . falls outside the perimeter of the rule." (31a-32a). Certainly that holding does not merit the attention of this Court on interlocutory petition.

The Court of Appeals Decided Correctly the Issues Which Were Presented to It.

Contrary to the contentions of petitioner, the Court of Appeals properly construed Exchange Rule 347(b); properly applied the non-waiver provision of the Exchange Act, section 29(a), 15 U. S. C. § 78cc(a); and properly interpreted the limited exemption from section 29(a) which is found in section 28(b) of the Exchange Act, 15 U. S. C. § 78bb(b). As the Court of Appeals held:

> "Although we find the question not free from doubt, we do not think that Exchange Rule 347(b) was intended to cover a controversy that has a causal connection to the fact of employment as remote as that involved in this dispute. All of the cases that have applied Exchange Rule 347(b) concerned the terms of the consensual relationship between registered representatives and Exchange members and the respective rights and duties of the parties as employer and employee.[1] While we have no occasion to mark the bounds of Exchange Rule 347(b), we believe the Rule was primarily designed to cover such disputes and that the present controversy falls outside the perimeter of the rule.

1. See *e.g., Stokes v. Merrill Lynch, Pierce, Fenner & Smith*, 523 F. 2d 433 (6th Cir. 1975); *Dickstein v. duPont*, 443 F. 2d 783 (1st Cir. 1971); *Isaacson v. Hayden, Stone, Inc.*, 319 F. Supp. 929 (S. D. N. Y. 1970); *Moritz v. Francis I. duPont & Co.*, 291 Minn. 523, 189 N. W. 2d 487 (1971).

"In our view, the dispute here has its primary genesis in an alleged securities fraud and concerns Ayres' right under federal and state securities laws as a stockholder and as a seller of securities. It does not center on Ayres' rights as a former employee under any consensual arrangement relating to the terms and conditions of his employment or termination. Although in a purely factual sense, the claims are connected with the termination of employment, the legal rights being asserted have a source wholly independent of the employment relationship. Arbitration is a matter of contract, and we do not think Ayres can reasonably be understood to have waived his right to judicial trial of such claims.

"The Supreme Court has characterized Exchange Rule 347(b) as relating to the 'exchange's housekeeping affairs' and has suggested it deals primarily with 'the area of wage claims.' *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U. S. 117, 136, 94 S. Ct. 383, 38 L. Ed. 2d 348 (1973). To conclude that the Rule applied under the unusual circumstances of this case would be, in our view, to stretch the Rule well beyond those goals. Here the arbitrators would be called upon to apply legal precepts whose importance transcends the Exchange's interests in self-governance and to draw upon far more than the specialized knowledge of industry needs and practices that makes arbitration appropriate when the terms and conditions of the employment relationship are at issue. *Cf. Alexander v. Gardner-Denver Co.*, 415 U. S. 36, 56-57, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974). Moreover, the Securities and Exchange Commission, which now has jurisdiction to amend, modify or repeal any Exchange rule, opposes any

construction which would make Exchange Rule 347(b) applicable under the circumstances of this case. See 15 U. S. C. § 78(b). Compare *Merrill Lynch, Pierce, Fenner & Smith v. Ware, supra,* 414 U. S. at 129-131, 94 S. Ct. 383. See page 538 below [37a-39a].

"Our conclusion that Exchange Rule 347(b) is inapplicable here is buttressed by the fact that even if Exchange Rule 347(b) was intended to govern controversies such as this, we believe it would, in any event, be unenforceable and invalid as applied to this case.[2] In *Wilko v. Swan,* 346 U. S. 427, 74 S. Ct. 182, 98 L. ed. 168 (1953), the Supreme Court held that the anti-waiver provision of the Securities Act of 1933, 15 U. S. C. § 77n, which is almost identical to § 29(a) of the 1934 Act, 15 U. S. C. § 78cc(a),[3] rendered 'void' a prospective agreement between a brokerage firm and a customer which would have required arbitration of the customer's claim under

2. The existence of countervailing federal policies, see *Wilko v. Swan, supra,* makes cases showing a hospitable attitude to the construction of arbitration clauses inapposite. For example, *United Steelworkers of America v. Warrior & Gulf Navigation Co.,* 363 U. S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960), on which Merrill Lynch principally relies, expressly terms "the run of arbitration cases, illustrated by *Wilko v. Swan* . . . irrelevant." Id. at 578, 80 S. Ct. at 1351.

3. Section 14 of the 1933 Act, 15 U. S. C. § 78n, provides:

> "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

Section 29(a) of the 1934 Act, 15 U. S. C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

§ 12(2) of the 1933 Act. We need not review here the fundamental and important differences between litigation in a court and arbitration.[4] It is enough to say that the Supreme Court found prospective waivers of the right to judicial trial and review to be inconsistent with Congress' overriding concern for the protection of investors. *Wilko v. Swan, supra,* 346 U. S. at 437, 74 S. Ct. 182; see *Scherk v. Alberto-Culver Co.,* 417 U. S. 506, 512, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974). As Merrill Lynch points out, a 'colorable argument can be made' that *Wilko v. Swan* should not apply to arbitration of judicially implied causes of action under the 1934 Act. We are not, however, persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrant such a distinction.[5] And we note that Congress appears to have accepted the view that *Wilko v. Swan* applies in the 10b-5 context. Cf. H. R. Rep. No. 94-229, 94th Cong., 1st Sess., at 111 (1975), U. S. Code Cong. and Admin. News 1975, p. 321.

• • •

4. See, *e.g. Alexander v. Gardner-Denver Co.,* 415 U. S. 36, 56-58, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974); *Wilko v. Swan, supra,* 346 U. S. at 435-37, 74 S. Ct. 182; *Bernhardt v. Polygraphic Co. of America,* 350 U. S. 198, 203 & n. 4, 76 S. Ct. 273, 100 L. Ed. 199 (1956).

5. This "colorable argument" was mentioned, but not explored, in dicta in *Scherk v. Alberto-Culver Co., supra,* 417 U. S. at 513-14, 94 S. Ct. 2449, a 5-4 decision in which the Court accepted the premise that *Wilko v. Swan* was applicable. The Court noted that the 10b-5 cause of action is judicially implied, whereas § 12(2) expressly provides a private cause of action, and that the 1934 Act vests exclusive jurisdiction in the federal courts while the 1933 Act grants concurrent federal and state jurisdiction.

"Merrill Lynch also argues that § 28(b) of the Securities and Exchange Act exempts Exchange Rule 347(b) from the invalidating effect of the anti-waiver provision of the Act. As amended,[6] § 28(b) provides:

> 'Nothing in this title shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, . . . or (3) of any action described in paragraph (1) . . . on any person who has agreed to be bound thereby.'

"Merrill Lynch argues that § 28(b)(3) operates to preserve the "binding effect" on Ayres of Exchange Rule 347(b). In their view, promulgation of Exchange Rule 347(b) constituted the type of 'action' contemplated by the statute and Ayres is a 'person who has agreed to be bound thereby.'

"We agree with Merrill Lynch that the term 'action taken by the authorities . . . to settle disputes between members or participants' includes Exchange 'action' in prescribing compulsory arbitration rules and is not limited to the actions of Exchange arbitrators in settling pre-existing disputes. See *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F. 2d 838, 841 (2d Cir. 1971); *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766, 774 & n. 18 (D. S. N. Y. 1968); 15 U. S. C. § 78c(a)(3)(26) (Supp. 1, 1976). But the mere fact that Ayres agreed to be bound by Exchange

6. Section 28(b) was amended by § 21(1) of the Securities Acts Amendments of 1975, 89 Stat. 160. Since the amendment does not affect the substance of the section in any way pertinent to this case, we have set out the section as it presently reads.

Rule 347(b) is not enough to bring that Rule within the exemptive provisions of § 28(b). Under the plain language of the statute, Exchange 'action . . . to settle disputes *between members or participants*' (emphasis added) is a prerequisite to application of § 28(b). Here that ingredient is missing. Exchange Rule 347(b) addresses controversies between registered representatives and member firms, not 'disputes between members or participants'. And it is undisputed that Ayres is not and has never been a 'member of or participant in any self-regulatory organization' for purposes of § 28(b).[7]

"Our construction of § 28(b) is mandated by the plain and unambiguous language of the statute. It is, as well, the interpretation suggested by the Securities and Exchange Commission, which has appeared in this case as amicus curiae. As the agency charged with the duty of administering the Securities Exchange Act and of supervising the stock exchanges' regulatory procedures, its view is to be given consideration. See, *e.g.*, *Saxbe v. Bustos*, 419 U. S. 65, 74, 95 S. Ct. 272, 42 L. Ed. 2d 231 (1974).

"The only case whose holding is arguably inconsistent with the view we have taken is *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F. 2d 838 (2d Cir. 1971). But see *Newman v. Shearson, Hammill & Co.*, 383 F. Supp. 265 (W. D. Tex. 1974). But the court in *Axelrod* did not discuss the question of whether § 28(b) was limited to 'disputes between members' and decided the question *sub silentio*, without apparent recognition of the problem. Moreover, *Axelrod* is distinguishable on both factual and policy

7. See 15 U. S. C. § 78(a)(3)(A) (Supp. I 1976) (definition of member); 15 U. S. C. § 78c(a)(3)(24) (Supp. I 1976) (definition of participant).

grounds.[8] See *Newman v. Shearson, Hammill & Co., supra,* 383 F. Supp. at 268-69." (31a-39a).

8. Axelrod involved a dispute between a member and a non-member firm. The non-member had instituted arbitration proceedings under Article VII, § 1, of the NYSE Constitution after a contract dispute had arisen. The member firm attempted to avoid the binding effect of the Constitution by commencing a federal court action and seeking to rescind the contract because of alleged securities violations. Against that background the court stated at pp. 842-43 of 451 F. 2d:

> "[T]he policy considerations relied on by the Supreme Court in *Wilko* are inapposite here. The Supreme Court found that the non-waiver provision there involved was designed to protect investors. 346 U. S. at 431. Without such provision, financial houses might escape statutory liability by taking advantage of the inferior bargaining position of customers. But the legislative policy of protecting investors will not be thwarted by compelling an exchange member to arbitrate, at the instance of a non-member, a dispute which is arbitrable under the exchange's constitution."

These holdings by the Court of Appeals are well-reasoned and sound, and are clearly consistent with prior decisions of this Court.

CONCLUSION.

There is no good reason for this Court to involve itself in this case at this time. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

—

CIVIL ACTION NO. 71-2986.
JURY TRIAL DEMANDED.

—

PERCY D. AYRES
370 Sycamore Avenue
Merion, Pennsylvania 19066,

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.
70 Pine Street
New York, New York,

Defendant.

AMENDMENT TO COMPLAINT.

Plaintiff, Percy D. Ayres, hereby amends his Complaint in the above action by adding thereto the following paragraphs:

"38. After July 14, 1970 the repurchase rights referred to in paragraphs 7 *et seq.* above were invalid and unenforceable, since they did not thereafter serve any valid, consistently adhered to, corporate purpose of defendant.

"39. Even if legal *per se* after July 14, 1970, defendant's exercise of those rights after that date constituted a violation of section 10(b) and Rule 10b-5, and common law fraud, since that exercise was without any justifiable corporate purpose and was for a fraudulent purpose.

"40. Defendant's conduct, as described above, was malicious, willful and intentional, and entitles plaintiff to exemplary and punitive damages."

and by adding thereto a demand for exemplary and punitive damages in an amount in excess of $625,000.00.

/s/ DAVID L. GROVE,
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